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WHAT AID CAN'T DO: REPLY TO RANIS

David B. Skarbek and Peter T. Leeson

Gustav Ranis addresses our recent article in this journal where we argued that foreign aid is unable to solve the economic problem and thus unable to make poor countries rich (Skarbek and Leeson 2009). The following quotations from his article summarize his main objections to our argument:

Instead of the MCC's [Millennium Challenge Corporation's] present grants-for-projects approach, favored by Easterly and Skarbek and Leeson, policy-based program lending or grants should be relied upon.

Skarbek and Leeson are ready to throw the baby out with the bath water. While foreign aid as presently practiced is admittedly flawed, there is no reason not to encourage at least this promising new window [a modified MCC] as a potentially valuable component of our long-term foreign policy arsenal [Ranis 2011].

We have two replies to Ranis's remarks. First, while we cannot speak for William Easterly, we can speak for ourselves. And we can say unequivocally that neither of us favors a grants-for-projects approach to foreign aid. Second, we question the ability of a

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David B. Skarbek is the Searle Visiting Assistant Professor of Political Science at Duke University. Peter T. Leeson is the BB&T Professor for the Study of Capitalism at George Mason University. Skarbek thanks the Searle Foundation, and Leeson thanks the Mercatus Center at George Mason University, for financial support.

modified MCC to address the plight of poor people in developing countries.

The Problem with a Grants-for-Projects Approach

The thrust of our original paper—which asked the simple question “What can aid do?”—was that *no* foreign aid initiative can solve the *economic* problem societies must solve to climb from poverty. That problem requires identifying the resource allocation that maximizes resources’ value to society. Grants for projects do not help us identify this. They are an example of what aid *can* do—increase a predetermined output by devoting more resources to its production—not what aid *must* do to make poor countries rich, which is to solve the economic problem stated above. Whether developed countries *should* use aid to increase a predetermined output by devoting more resources to its production is a normative question. Our original argument analyzed a positive one.

Markets solve the economic problem required to make poor countries rich. But markets require a system of private property rights. Developing countries lack such a system. That is why they are undeveloped.

If the major impediment to developing countries adopting a system of private property rights were a lack of finances, aid could contribute to relieving poverty *indirectly* by financing the creation of such a system—assuming that all relevant parties had the incentive to use it for the purpose. But we doubt that is the case. As Peter Bauer (2004) pointed out, every rich country in the world was once poor. Yet somehow their governments managed to develop systems of private property protection despite their poverty and without external assistance.

There is another reason it is strange to see governmental resource constraints as the main impediment to private property protection in developing countries: The greatest violators of private property rights in developing countries are their *governments*. If developing-country governments want to secure property rights in their countries, there is a simple step they can take: stop meddling in citizens’ economic activities and stealing from them.

Improving the Plight of the Poor

Our second response to Ranis addresses the ability of his envisaged, modified MCC to improve the plight of poor people in developing countries. Ranis would like an MCC that “act[s] like a bank.” Developing-country governments would apply to this bank-like MCC with a package-of-reforms proposal. If the MCC deemed a proposal worthwhile, it would loan that government money.

While we share Ranis’s assessment that the existing MCC has failed to improve the plight of poor people in developing countries, we do not share his optimism about a bank-like MCC’s ability to do this. There are two possibilities: (1) a developing-country government credibly commits to stop plundering its citizens and to devote its energies to protecting their private property rights; (2) it does not credibly commit to stop plundering its citizens and continues to devote its energies to violating their private property rights.

In the first case the MCC will (presumably) give the government a loan. But the government does not need the loan if it has truly committed to protecting citizens’ private property rights. Its citizens will become wealthy without it. In the second case, the MCC will (presumably) not give the proposing government a loan. But in that case the proposing government’s citizens will continue to suffer in poverty. The policy-based lending that Ranis’s modified MCC would engage in is peculiar if the MCC’s goal is to improve the plight of the poor. It makes loans to countries whose citizens will soon become rich without them and refuses loans to countries whose citizens will continue to suffer in poverty.

A bank-like MCC may just really be a glorified agency for bribing developing-country governments. It pays corrupt politicians to stop being corrupt. If corrupt politicians could credibly commit to stop being corrupt after receiving an MCC bribe, this could work. But it is unclear how corrupt politicians could do that. And we don’t think this is what Ranis has in mind.

Conclusion

Foreign aid cannot solve the economic problem. That requires markets, which require private property rights. If a developing-

country government protects private property rights, that country will become rich. If it does not, that country will remain poor. A bank-like MCC that conditions aid on governments undertaking reforms that establish property protection gives aid only to countries that do not need it. Aid would not be solving the economic problem in such countries. Markets grounded private property rights would be. And, last we checked, markets grounded in private property rights did not require aid. In his article's title, Ranis asks if we are giving up on aid. The short answer is, yes, we are giving up on aid but embracing markets grounded in private property rights.

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